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C O N F I D E N T I A L SECTION 01 OF 03 ANKARA 002720

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USDOC FOR 4212/ITA/MAC/CPD/CRUSNAK
EEB FOR A/S SULLIVAN
EUR FOR DAS BRYZA
SCA FOR MANN
DOE FOR HEGBURG
USTDA FOR DAN STEIN

E.O. 12958: DECL: 11/06/2017

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SUBJECT: DAS BRYZA AND TURKISH ENERGY MINISTER GULER ON
CASPIAN ENERGY AND SHAH DENIZ GAS

REF: BAKU 01292

Classified By: Economic Counselor Dale Eppler for reasons 1.4 (b) and (d)

11. (C) Summary: On October 25, EUR DAS Matt Bryza met with Turkish Energy Minister Guler and reaffirmed their commitment to a shared U.S.)Turkey strategic vision to help Europe diversify its natural gas supplies away from dependence on Russia. Guler warmly welcomed positive news from Bryza on emerging gas supplies for Nabucco and was especially keen to learn more about Turkmenistan,s interest in this project. Guler believes Turkmenistan is key to the project. On transit issues, Guler is ready and willing to reopen negotiations with Azerbaijan. He is ready to compromise on some important issues) including an agreement not to resell Azerbaijan gas) but said the GOT will not abandon the idea of net-back pricing on 15% reserve from gas exported to Greece and Italy from Azerbaijan,s Shah Deniz field. On Iran, Guler said that if other sources of gas materialize, USG concerns about Turkey's energy cooperation with Iran will "go away." End summary.

12. (C) Bryza reviewed progress in identifying gas supplies for the Turkey-Greece-Italy (TGI) and Nabucco gas pipelines. Bryza noted Azerbaijan,s commitment to provide sufficient gas to fill TGI and the initial phase of Nabucco; Turkmenistan,s interest in continuing the discussion of linking existing Petronas off-shore blocks to Azerbaijani gas infrastructure in Baku; and the potential for Iraq to provide gas for Nabucco from Anbar Province (through Syria) and from northern Iraq to Turkey. Bryza pointed out that if Turkey and the U.S. succeeded in helping countries and companies synchronize investments to realize TGI and Nabucco with Azerbaijani, trans-Caspian, and Iraqi gas, Turkey would not need Iranian gas to meet its growing internal gas demand. Guler agreed, and responded with an anecdote: &if I have five cups of tea, why do I need a sixth?8

13. (C) Guler was enthusiastic about the prospect of Turkmen gas for Nabucco and said it is a high priority for Turkey and a key to making the project work. He said he didn,t think

Russia or Iran could block this initiative with environmental arguments or demands to clarify the division of the Caspian Sea. He asked for more details on timing. Bryza said we couldn't predict timing, but that the U.S. would welcome effort by Turkey to foster deeper cooperation between Azerbaijan and Turkmenistan, including a possible call by Turkish PM Erdogan to the Presidents of Azerbaijan, Turkmenistan, and Kazakhstan to convene a summit meeting. Guler said the press of other business had prevented him from discussing Nabucco with PM Erdogan lately, but he was encouraged by Bryza's news and would raise Nabucco with the PM including the issue of whether Turkey supports additional partners joining the Nabucco consortium. (In ref A, Embassies Baku and Ankara reported that the lack of a quorum on the BOTAS (state-owned pipeline company) board was delaying a decision on RWE's offer to join the Nabucco consortium. Guler's statements indicate that this decision will be made by the Prime Minister and ratified by the BOTAS board, which could speed up the decision-making process.)

14. (C) On gas transit, Bryza and Guler reaffirmed the common U.S.-Turkish strategic goal of bringing non-Russian gas to Europe through a diversity of routes. Guler said Turkey wanted to make the Southern Corridor work, but was having difficulty reaching agreement with Azerbaijan. He defended the formula of 15 percent reserve with netback pricing (under which the Turkish price for gas would be the Greece price minus the transportation fee across Turkey) as a common practice in the gas business and said it is used by Gazprom to set prices in Europe. He argued netback formulas are fair because Turkey's price for gas should not include the cost of transit across its territory and transparent because they are calculated using a transparent transit methodology that is spelled out in the July 26

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inter-governmental agreement among Turkey, Greece, and Italy.

Bryza relayed arguments by Edison, the Italian energy company developing the TGI pipeline, that TGI's netback pricing scheme for Turkey could be more advantageous to Azerbaijan than other transit schemes in which transit countries take natural gas at a local market price as a transit tax because under the TGI scheme, Azerbaijan will lose a fixed cost (the cost of transit across Turkey) rather than a variable cost (the market value of a volume of gas which varies with the price of Brent crude). Guler said that Azerbaijan needs to be realistic in its negotiations with Turkey and it should act quickly to come to an agreement because other competitors like Russia benefit from inaction on Nabucco. Bryza agreed on the need to reach agreement expeditiously to avoid ceding the field to monopolists.

15. (C) Guler expressed GOT's willingness to restart negotiations with Azerbaijan as soon as possible. He expressed frustration that previous negotiations resulted in the government of Azerbaijan and SOCAR passing the buck back and forth on some of the tough issues, leaving Turkey in doubt about whom they should be negotiating with. Guler was firm in his defense of the TGI transit scheme but showed significant flexibility on the details of the formula. He said if the main principle of net-back pricing and a 15 percent reserve could be agreed, Turkey would consider signing an agreement prohibiting the resale of Azeri gas, as well as pricing additional gas volumes between the Russian and Italian price. He added that Turkey has a broad-based relationship with Azerbaijan and many things could be on the table as a sweetener to the agreement. Specifically, Guler mentioned Azerbaijan's electricity debts to Turkey and increased or preferential trade arrangements as possibilities.

16. (C) In response to Bryza's suggestion that Guler convene the four countries (Turkey, Italy, Greece, and Azerbaijan) involved in the Turkey-Greece Interconnector (TGI) to jump start negotiations, Guler preferred to meet directly with

Azerbaijan, since an agreement was already in place with Greece and Turkey. Guler ended the meeting by saying he has taken our advice⁸ on inviting the Azerbaijan government to the official TGI opening ceremony scheduled to take place at in Greece on November 18.

¶17. (C) In a pull-aside at the end of the meeting, Guler emphasized to Bryza that Iran was not Turkey's preferred gas supplier, and that if other sources of gas materialize, USG concerns about Turkey's energy cooperation with Iran would "go away." Bryza said that he looked forward to working with Turkey to make the needed Caspian and Iraqi gas supplies a reality.

¶18. (C) Comment: Turkey and U.S. interests continue to be aligned in developing the Southern Corridor as a means to diversify sources of gas supply away from dependence on Russia. Turkey's engagement with Iran is the biggest point of contention. The real driving force behind this cooperation is uncertainty about gas supply from non-Russian, non-Iranian sources. If we can help Turkey meet its gas demand with other sources, we may be able to limit Turkey's willingness to do business with Iran.

¶19. (C) Comment continued: On transit issues, Guler was steadfast in his support for a net-back pricing/15 percent reserve scheme for Shah Deniz gas. However, the good news is that Turkey does want to reach an agreement soon and appears ready to make some important concessions (like not reselling Azeri gas) in order to reach one. Guler's hostility to a meeting of the four TGI countries probably arises from his fear that such a meeting could initiate a re-negotiation of the intergovernmental agreement, which would not be in Turkey's interest. We believe a GOT-Government of Azerbaijan meeting would be a good next step. End comment.

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¶10. (U) This cable was cleared by DAS Bryza.

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